

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL  
LEGISLATURE AND THE COUNCIL ON THE NELSON MANDELA BAY METROPOLITAN  
MUNICIPALITY**

**REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying consolidated and separate financial statements of the Nelson Mandela Bay Metropolitan Municipality, which comprise the consolidated and separate statement of financial position as at 30 June 2011, and the consolidated and separate statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages XX to XX.

**Accounting officer's responsibility for the consolidated financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010, as amended) (DoRA) and the Companies Act of South Africa, 2008 (Act No. 71 of 2008), as well as for such internal control as management determines necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these consolidated and separate financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## **Opinion**

7. In my opinion, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with GRAP and the requirements of the MFMA, DoRA and the Companies Act.

## **Emphasis of matters**

8. I draw attention to the matters below. My opinion is not modified in respect of these matters:

## **Significant uncertainties**

9. As disclosed in note 45 to the consolidated and separate financial statements, the municipality is the defendant in a number of lawsuits to the value of R165,2 million. The municipality is currently opposing these claims, but the ultimate outcome of these matters cannot presently be determined.
10. As disclosed in note 46 to the consolidated and separate financial statements, the council must still consider the Kabuso Report made public on 20 October 2011 and determine a course of action to deal with potential recoveries in relation to the possible unauthorised, irregular as well as fruitless and wasteful expenditure. Irregular expenditure related to this report is included in the amounts disclosed in note 44 to the financial statements.

## **Restatement of comparative figures**

11. As disclosed in notes 40 and 41 to the consolidated and separate financial statements, the comparative figures for 30 June 2010 have been restated as a result of changes in accounting policies and errors discovered during the financial year ended 30 June 2011 in the financial statements of the municipality at, and for the year ended, 30 June 2010.

## **Irregular and fruitless and wasteful expenditure**

12. As disclosed in note 44 to the consolidated and separate financial statements, irregular and fruitless and wasteful expenditure of R63,4 million was incurred during the financial year. Irregular expenditure was incurred in contravention of the supply chain management (SCM) requirements, and fruitless and wasteful expenditure was made in vain and would have been avoided had reasonable care been exercised.

## **Material losses and impairments**

13. As disclosed in note 35.12 to the consolidated and separate financial statements, water losses of 22 961 megalitres (26,2% of annual water usage) amounting to R135,9 million were incurred during the financial year.
14. As disclosed in note 35.8 to the consolidated and separate financial statements, government debt of R41,2 million was impaired during the financial year.
15. As disclosed in note 28 to the consolidated and separate financial statements, bad debt expenditure amounted to R554,3 million. This was due to bad debt write-offs of R119,6 million and an increase of R434,7 million in the provision for doubtful debts.

## **Material underspending of the budget**

16. As disclosed in note 53 to the consolidated and separate financial statements, the municipality underspent its capital budget by R154,4 million.

**Additional matter**

17. I draw attention to the matter below. My opinion is not modified in respect of this matter:

**Unaudited supplementary schedules**

18. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

**REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

19. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages XX to XX and material non-compliance with laws and regulations applicable to the municipality.

**Predetermined objectives**

20. There were no material findings on the annual performance report concerning the presentation, usefulness and reliability of the information.

**Compliance with laws and regulations****Annual financial statements**

21. The financial statements of the municipality and its municipal entity, the Mandela Bay Development Agency (MBDA), submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements relating to capital and current assets, liabilities, expenditure and disclosure items in the municipality's financial statements and material misstatements relating to disclosure items in the MBDA's financial statements that were identified by the auditors were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

**Procurement and contract management**

22. The municipality and its municipal entity procured goods and services with a transaction value of between R10 000 and R200 000 without obtaining written price quotations from at least three different prospective providers, as per the requirements of Municipal Supply Chain Management Regulation (SCM Regulation) 17(a) and (c) of *General Notice 868 of 2005* issued in *Government Gazette 27636 of 30 May 2005*.

23. The municipality made awards to providers whose directors or principal shareholders were persons in the service of other state institutions in contravention of SCM Regulation 44. Furthermore, the providers failed to declare that they were in the service of the state as required by SCM Regulation 13(c).

24. The entity made awards to suppliers who did not submit a declaration on their employment by the state or their relationship to a person employed by the state as per the requirements of SCM Regulation 13(c).

25. The municipality procured goods and services of a transaction value above R200 000 without inviting competitive bids as per the requirements of SCM Regulations 19(a) and 36(1).

26. The providers in which close family members of persons in the service of the municipality had a private or business interest in contracts awarded by the municipality, failed to declare their relationship to those persons employed by the municipality as per the requirements of SCM Regulation 13(c).
27. Invitations for competitive bidding were not always advertised by the municipal entity for the required minimum period as per the requirements of SCM Regulation 22(1) and 22(2).
28. Sufficient audit evidence could not be obtained that awards had been made by the municipal entity to providers whose tax matters had been declared to be in order by the South African Revenue Service as required by SCM Regulation 43.

#### **Expenditure management**

29. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
30. The accounting officer of the municipality did not take reasonable steps to prevent irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
31. The accounting officer of the municipal entity did not take reasonable steps to prevent irregular expenditure, as required by section 95(d) of the MFMA.

#### **Human resource management**

32. The acting municipal manager did not sign an annual performance agreement for the year under review, as required by sections 57(1)(b) and 57(2)(a) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).

#### **Asset management**

33. The accounting officer of the municipality did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets as required by section 63(2)(c) of the MFMA.

#### **INTERNAL CONTROL**

34. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the findings on compliance with laws and regulations included in this report.

#### **Leadership**

35. Ethical business practices and good governance is not enforced by top management at all times, resulting in a number of cases of fraud and theft relating to Supply Chain Management (SCM) practices.

36. The municipality did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place and that performance was adequately monitored. A large number of key positions, including the municipal manager position, were vacant for more than 12 months and were staffed with acting appointments. There were significant control deficiencies relating to appointment processes, leave administration and suspensions.
37. The municipal entity lacked sufficient monitoring processes to detect contraventions of the SCM policy.
38. Detailed standard operating procedure documents were not readily available to deal with the day-to-day running of the municipality.
39. The municipality did not have an information technology (IT) governance framework to support the reliability of the systems and the availability, accuracy and protection of information.

#### **Financial and performance management**

40. Documentation related to human resources in support of the amounts in the consolidated and separate financial statements was not easily retrievable, as there were significant deficiencies relating to the filing of documentation.
41. A centralised filing system with respect to the filing of the municipality's SCM documentation was not in place for the full year under review. Difficulties were experienced in obtaining complete, relevant and accurate information in respect of tenders awarded.
42. The checklist used by the municipality to assess individual tenders was not comprehensive enough to ensure adherence to all SCM laws and regulations.
43. The fixed asset register of the municipality was not reconciled on a regular basis to ensure that discrepancies were identified and rectified in a timely manner.
44. The municipality implemented processes in the current year to identify related party transactions; however, these controls were not completely effective as not all related party relationships and transactions were identified and disclosed in the consolidated and separate financial statements.
45. The review and monitoring of compliance with laws and regulations by the municipality were not effective, as there were a number of cases of non-adherence to SCM laws and regulations.
46. The municipal entity's processes to identify and report irregular expenditure were inadequate. This resulted in irregular expenditure not being identified and addressed in a timely manner.
47. The municipality's manual and/or automated systems were not completely effective for the recording of and reporting on creditors, leave and irregular expenditure. Alternative audit procedures had to be performed to ensure the completeness of the affected account balances and disclosure.

48. The design and implementation of formal controls over municipal IT systems require improvement to ensure the reliability of the system and the availability, accuracy and protection of information, as there were control weaknesses relating to security management, user access control, program change management and IT service continuity.

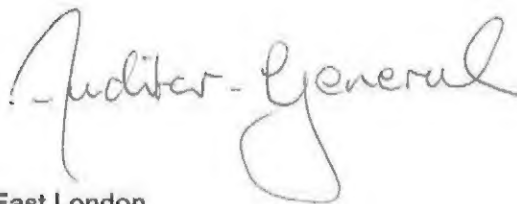
#### **Governance**

49. Regular risk assessments were undertaken; however, the effectiveness of the monitoring of compliance with the action plans was hampered due to the fact that the municipality's risk officer position is currently vacant.

#### **OTHER REPORTS**

##### **Investigations**

50. As disclosed in note 44.4 to the consolidated and separate financial statements, investigations into several alleged transgressions are currently in progress and may result in unauthorised, irregular or fruitless and wasteful expenditure.
51. Twenty-two investigations were completed during the year. The irregular expenditure relating to these investigations was included in note 44.3 to the consolidated and separate financial statements.



East London

13 December 2011



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*